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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000323

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SUBJECT: AZERBAIJAN: FINANCE MINISTER TALKS CIS, G20, NO
DEVALUATION

Classified By: Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,
d)

¶1. SUMMARY: In an April 7 meeting, Azerbaijan's Finance Minister, Samir Sharifov, defended his ministry's policy of supporting the manat (currency) and indicated that the policy would not likely be changed any time soon. He also described deliberations at the March 30 meeting of CIS Finance Ministers in Moscow, at which President Medvedev briefed on the upcoming London G-20 Summit and the GOR offered its analysis of the crisis and next steps. Sharifov commented at length on key issues to be considered in revamping the global financial structure and the institutions that support it. CIS Finance Ministers would like more information on how the budget and financing mechanisms work in reserve currency issuing countries, he said. Pointing to Russia's efforts to shape the regional discussion on the crisis through the CIS Finance Ministers forum, Sharifov requested more regular dialogue with the USG on U.S. financial policies and developments and suggested that the USG consider sending an expert to the region to brief on USG responses to the crisis.

End Summary.

RUSSIANS COORDINATING CIS ECONOMIC RESPONSE

¶2. Finance Minister Sharifov invited the Ambassador and USAID Country Coordinator to his offices on April 7 to sign a \$45 million MOU under which the USG and GOAJ will co-finance a number of important USAID economic and community development technical assistance programs. The MOU is the first of its kind for USAID, and the result of discussions launched under the bilateral Economic Partnership Commission in February 2007. Minister Sharifov took the opportunity to offer his views about the global economic crisis and GOAJ monetary policy. He told the Ambassador that at the March 30 CIS Finance Ministers meeting in Moscow, which he had attended two days before the G20, the CIS Ministers, led by Russian Minister of Finance Aleksey Kudrin, had come to the same overall conclusion as the G20, that stimulus and international coordination were the keys to overcoming the global financial crisis.

¶3. Sharifov informed the Ambassador that Russia was trying to set itself up as the representative of the CIS countries at the G20, but cautioned that their ideas were not always coincident. He noted that reform of the Bretton Woods system would negate the need for outside assistance, such as that offered by Russia. He also suggested that some countries which act as reserve currency issuers (namely the United States) have irresponsibly reaped the benefits of their position and that global financial reform should require them to be more transparent and responsible in their financial dealings. He pointed out that if the U.S. dollar has

problems, then so does the Azeri manat, which has been pegged de facto to the U.S. dollar and is the international currency for oil contracts.

¶14. The Minister noted that at the CIS Finance Ministers' meeting there was some concern that increasing liquidity could trigger a "new" bubble. He believes the best way to fix the current problems is to restore confidence, stressing that a liquidity crunch and immobility of money markets requires a liquidity injection. Sharifov said that the consensus at the CIS Finance Ministers meeting was a call for immediate steps to strengthen the global regulatory environment. He also noted that the CIS Finance Ministers would like more information on how the budgets and financing mechanisms work in reserve currency issuing countries. He requested more dialogue with the USG on U.S. financial policies and developments and suggested the USG send an expert to the region to explain USG views on responses to the crisis in depth.

ROLE OF IFIs IN THE NEW WORLD ORDER

¶15. Sharifov spoke at length about the role of IFIs in the Bretton Woods system, specifically the IMF, and how it could perform a greater function in the global financial system. He noted the IMF's inability to adequately respond to or predict the recent global financial crisis, stating that "it simply follows events." The Minister is in favor of strengthening and recapitalizing the IMF and said that he believes it should be more proactive. He also commented that

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Russia would soon ask for a higher profile in the IMF, highlighting that Azerbaijan "has no such ambitions."

¶16. The Minister then revealed his ideas on ways to improve the global financial system by expanding the role and authority of IFIs in general. He believes that they should have greater responsibility for supervision, as well as additional authority to monitor hedge funds and derivative transactions. Sharifov expressed interest in more regulations in general and greater interaction between national regulators at the highest levels. When asked to elaborate on his idea of a "global financial board," he explained that he was more concerned in creating an organization that would serve a more consultative function rather than as a guiding or regulating body.

IN DEFENSE OF THE MANAT - NO DEVALUATION ON THE HORIZON

¶17. When asked how and why the GOAJ was continuing to prop up the manat, despite serious downward pressure and similar actions within the region, Sharifov claimed that there was "no rush" to devalue the manat. He acknowledged that there had been a brief "splash for cash" after the devaluation spree in neighboring countries, especially Kazakhstan, but maintained that the situation had stabilized. He reminisced that the financial crisis of '99 was much worse when the devaluation of the Russian ruble led to a flood of cheap imports which crowded out local business and prompted the GOAJ at that time to devalue the Azeri manat.

¶18. Sharifov contended that an "unhealthy mental environment" sparked the speculations but, unlike during the previous rush, the Central Bank situation is healthier overall this time. He noted that the GOAJ balance of payments structure is healthy and the Central Bank's discount rate is three percent. He believes that Azerbaijan, despite a very strong currency, is still competitive because decreased global demand decreases demand for imports in Azerbaijan creating a demand for import substitutions. Sharifov is convinced that there is no need to depreciate the manat, because "the negative effects would be more detrimental than the cost to support the currency." He also noted that there was no

current pressure on the manat, as speculative debt instruments largely do not exist in Azerbaijan. The GOAJ nonetheless would continue to support and monitor the situation, and complete an ongoing bank stress, test.

¶9. In conclusion, Sharifov noted that the financial crisis has foreign roots. It is not a one-year crisis, he said, and global and regional economies will take time to recover. Azerbaijan, meanwhile, will promote growth in non-energy sectors, such as agriculture. The government is also taking care to promote a sustainable budget. Simultaneously, the Ministry of Finance, in conjunction with the Central Bank, will examine the financial sector, extending short-term loans and refinancing as necessary, and looking to address deteriorating asset values.

¶10. COMMENT: The Minister's detailed description of his travel to Moscow for the CIS financial summit highlights the expanding role that Moscow plays in this region, as well as Central Asia. The meeting came just ahead of the London G20 Summit, and gave CIS financial ministers, who, other than Kudrin, did not have a seat at the table, an opportunity to weigh in on international issues. Minister Sharifov said he expects Russia to continue and develop the CIS Finance Ministers forum, which has now met twice. In the run up to the G-20 Summit, Russia, took advantage of an excellent opportunity to expand its reach in the region. According to Sharifov, Kudrin said Russia had spent USD 200 billion to stabilize the currency situation at home, and as a result hard currency demand has slowed. Russia, meanwhile, was looking to extend loans to other CIS countries, with perhaps USD 500 million to Armenia, USD 2 billion to Kyrgyzstan, USD 2 billion to Belarus, and USD 5 billion to Ukraine. We highlight the Minister's call for more USG dialogue on economic and financial issues, and will follow up here. This issue should be a top agenda item at the next EPC meeting, tentatively slated for June in Baku. We also see value in the Minister's suggestion that USG experts make a swing through the region to brief interested governments on USG views on the crisis and responses.

DERSE